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Securities Industry Trends

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OPPORTUNITIES IN THE 1990s

A Summary of Presentations at the 1987 Trends Conference*

The theme of the 1987 Trends Conference was "Opportunities in the 1990s." The day's conference featured various senior brokerage industry executives addressing the future of Wall Street and brokerage firms for the next decade. Topics ranged from perspectives about the overall opportunities available to brokerage firms in the capital and retail markets to specific subjects such as globalization, new products in the capital markets area, and firms taking principal positions in their own deals.

In addition to projected changes in the capital markets, the afternoon session reviewed overall changes in the retail markets, market segmentation and asset gathering, and the outlook for traditional and packaged products. One of Wall Street's leading spokesmen concluded the day with his reflections on past changes and probable future changes as well.

This issue of Securities Industry Trends summarizes the conference speakers' remarks concerning opportunities in the securities industry in the 1990s.

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* The full transcript of the 1987 Trends Conference is available for $75. An order form is enclosed.

OVERVIEW OF CAPITAL MARKET CHANGES

George L. Ball
Chairman and Chief Executive Officer
Prudential-Bache Securities

If you just look at the here and now, it is relatively clear that the marketplace is in something of a state of frenzy. Unfortunately, today's environment is about as sustainable as the afterglow from the third martini.

For now, however, the demand for shares is going to be augmented enormously by two important new sources, one from the east and the other from the rest.

Now, the new demand from the east is clearly the Japanese. The Japanese have begun to discover the U.S. equity markets. The other big source of increased demand, the rest, is the individual investor. In 1986 the strength in the market was in the blue chip institutionally dominated stocks. Now the trend has begun to shift rather rapidly, in another direction. The individual likes small cap stocks and lower price stocks. Also dead ahead, is a potential crisis. We may well run a very serious test of the industry's operations and execution capability.

We may indeed be over-confident of our ability to process, to execute, and deliver clean statements to clients promptly if volume really mushrooms and the individual comes back on an exponential basis.

If we get into a processing crunch, bankers are going to be quick to boast of their prowess in terms of an ability to crunch paper. So what's paramount is that we avoid a problem in the first place.

On the capital markets side, the big Mount Everest type of change is that firms are going to have to put their own financial resources at risk with far greater frequency than ever in the past.

Similarly, investment banks used to simply facilitate mergers and acquisitions. Nowadays, they have to be willing to put their own dough on the line. In other words, firms are being forced to become traders in whole companies rather than simply traders in stocks. This means two things -- greater risk and squeezed profit margins.

On a different front, costs have gone up far too far. In 1986, personnel costs rose by 30%, and non-personnel costs were up 25%. That is both unacceptable and unsustainable. A bull market is once again creating a fixed cost base which is impossible to contract rapidly enough when things slow down.

Longer term, what else lies ahead? In the late 1980s to early 1990s, a big trend which is going to take place is the re-equitization of American business. American business has never been as highly leveraged as it is today and that is a fool's paradise. When the economy falters or interest rates rise, the debt is going to become too heavy a weight for the leveraged balance sheets to bear. Therefore, a solution needs to be found and the good news is they are going to need to turn to us to revitalize their balance sheets with equity.

Another big revenue source for which most of us are ill-prepared is currencies. Currencies are perhaps the biggest development on the investment horizon. Clients need access to currency capabilities for a variety of risk avoidance reasons. As currency swaps become as commonplace as interest rate swaps have been, I think you're going to see a flocking to cross-border, cross-currency opportunities.

The big revolution, in the retail business, is that account executives will increasingly take on the role of investment manager for households. As part of the process of the metamorphosis, by 1991, performance fees will begin to permeate the retail sector. Retail brokers will have to produce attractive investment results for their clients or they're going to be paid like discount brokers. Packaged products, like mutual funds and limited partnerships, are going to wane while in the higher risk areas, like mezzanine equity, technology, and high beta stocks, they will wax mightily. Also, by 1990, the maximum tax rate will be 40% plus or minus. As a result, pure tax shelters are going to rise again like Phoenix out of its own ashes.

Globalization and Merchant Banking

David C. Batten
Executive Director
Credit Suisse First Boston

There are six components of globalization: deregulation, information, computerization, innovation, securitization and disintermediation.

Governments and regulators around the world, over the past five years, have eliminated barriers to entry for foreign intermediaries, have expanded the range of activities they can legally pursue, have relaxed or abolished interest rate ceilings and foreign exchange controls, and have expanded the range of investment vehicles in which local market participants may deal.

One of the results is that the competitive oligopolies in many national markets have and are continuing to break down.

In the Euromarket, the top five firms had a 45% market share in 1982, but only a 35% market share last year. Over the same time frame, the development of high speed on line systems, and new and more flexible software, have allowed faster, if not instantaneous, collection, manipulation and dispersion of massive amounts of data to market participants worldwide. We have seen an explosion of new products and structures which can be bundled and unbundled in an almost unlimited form to meet the specific requirements of investors and issuers.

Finally, in liquifying new assets such as mortgages, auto receivables and computer leases, and in creating new vehicles such as Eurocommercial paper, we have redirected significant amounts of savings flows and fundamentally changed the investment process around the world.

Also, during the past three or four years, nothing has had as dramatic an effect on capital markets as had the development of the swap mechanics. In part fueled by swaps, Eurobond and foreign bond new issue volume expanded from under $70 billion three years ago to over $215 billion last year.

In the past, new issue activity was substantially dependent upon the net financing needs of borrowers. Today, swap-induced dynamic management of assets and liabilities triggers capital market new issue volume which is independent of borrowers' net financing needs.

On the equity side, this globalization process has been slower but is now picking up speed with a vengeance. According to the SIA's own figures, net foreign purchases of U.S. equities in the first nine months of 1986 totalled $18.3 billion. In 1985, it was $4.9 billion and the previous full year record had been in 1981 when the number was $5.8 billion.

It's also interesting to try and assess the impact of these developments on market participants. For example, let's look at a CFO who wants to raise intermediate-term fixed rate dollars. You go back 10 years, he had two options -- basically, public and private. But today, through interest rate and currency swaps, he has five dozen alternatives through securities and swaps -- more if we add synthetic approaches, and even more if we secure the possible securitization of assets which might serve to obviate the need for the fixed-rate financing in the first place.

In terms of financial intermediaries, the implications are staggering if a firm hopes to be a world class player in the 1990s. Competitive forces require that we invest in the people, the hardware and the software to generate the knowledge required to deliver these products. Less than a full service approach means we're vulnerable to losing transactions to a firm who's invested in a marketplace that we've ignored. Being fully competitive requires huge investments in the three major

markets which I would call packaging centers -- London, Tokyo and New York. It also requires providing as much computer capability to your mortgage and asset finance departments as would have been required to run your whole firm just a few years ago. Being fully competitive requires that you take risks as principal on an ongoing basis.

I defined a world-competitive investment bank today as being willing to take huge risks as principal in assets we call securities and swaps. One definition of merchant banking is an intermediary who takes risks as principal in corporate assets.

If properly conceived and structured, the revenue from the sale of these assets or from their financings can provide significantly better returns. The business of bridge financing seems to me a logical extension of our current recapitalization and M&A businesses, as does that of operating as principal in LBOs. The credit analysis and judgments on cash flows are key components of the due diligence we already perform. The new element of this equation is liquidity, and I would argue that if compensation is adequate the risk is acceptable and that, in fact, these kinds of merchant banking activities are compatible, if not complementary, to businesses in which we already engage.

NEW PRODUCTS IN THE CAPITAL MARKETS

Ronald D. Gallatin
Managing Director
Shearson Lehman Brothers Inc.

Starting in 1981, we had the evolution of the modern new product era in investment banking. It resulted from two very major factors -- partial derequlation of the industry and very high interest rates. I think one could almost call the 1980s the decade of unbundling and the first product would be the zero coupon bond. We then went from the zero coupon bond to what was referred to as either a cat, lion, tiger or cougar, which was the zero coupon treasury. The idea was to go take this wonderful piece of paper they had called a government bond and start cutting it up into little pieces. This is the classic case of unbundling. The last step was when we went back to the corporate market and created the serial zero. And this unbundling of the totality of the bond really started an evolutionary process. It went further on into areas like interest rate swaps.

Since issuers want to borrow at the optimum rate, we showed them that they can borrow cheaper in the Euromarket. They can borrow cheaper if they borrow in different currencies even though it may not be a currency they actually want to be borrowing in. What all of these pieces of a transaction are

doing is bundling itself back to the real piece of paper, a nice, standard piece of debt. When you're finished with the flow charts, what the CFO's mindset is, is that he went out and borrowed what he wanted to borrow and all these machinations are nothing more than getting him the lowest possible debt rate.

Next, as interest rates went all the way up, we found a tremendous amount of risk aversion, and this risk aversion had to be handled by the marketplace. Risk aversion can best be described by taking you through what happened in the preferred stock market during a period of the 80s.

The 80s started with something that was called fixed rate preferred. The problem with a fixed rate preferred stock from the buyer's standpoint was that if interest rates were to go higher, by definition, the value of that preferred stock went lower. So a creative product came up, and it was called adjustable rate preferred.

There was a formula that was used in the adjustable rate preferreds that as Treasury rates went up, the dividend rate went up. What we found out in the marketplace was that formulas are wonderful and they're always accurate the day that you price them at par, and they're always inaccurate approximately five seconds after you break syndicate or unfortunately sometimes before you break syndicate.

And we then went on to the next product, because the formulas didn't always work. We came up with an auction process for the dividend to be absolutely sure that it will always trade at par. We've started with whole animals called bonds, preferred stock, common stock, and bundled and unbundled them.

The difference that appears to be coming up for the 90s, once we get to full globalization, is that people are buying in markets that they're not totally familiar with. When this happens, I think you may see a reverse of the process. The buyer is going to say, "I don't understand all this, so I need a multitude of protections. Maybe some of my money should be in Swiss francs and some in dollars and I should be in banks of one country and in industrials of another country." As a result, whether they're done as funds or something as simple as old time converts, you're going to see a lot of transactions combining the various facets that we've been doing all the unbundling on.

I'd like to touch on two more areas. One is asset-backed financing. Now, asset-backed financing started off slowly. In the 1990s, this market will be hundreds upon hundreds of billions of dollars. The reason that this market started as slowly as it did is twofold. The first reason was that the rating agencies needed a lot of convincing of precisely how the formulas would work before they put a rating on it. They

needed a lot of work and a lot of hand-holding. A lot of that has been done and they have now geared up.

The second major factor is the fact that the marketplace doesn't like a security it doesn't understand, and that it can't trade. Until they could understand what the prepayments were going to be, they couldn't evaluate how long the piece of paper is. Now they can.

The reason why the 90s will proliferate asset-backed financing is one very simple reason: interest rates are not going to stay at the rate they are today. When rates are low, it's not worth it for the issuer to pledge his best assets to save 20 basis points. What is going to happen, is that rates are going to go a lot higher.

In fact, if we had developed these new products in the 70s and then we got to the interest rates of the early 80s, you would have seen nothing but asset-based financing.

The last item I would bring out would be commodity backed bonds with the interest rate and/or the ultimate principal repayment determined by the price of an underlying commodity. Corporate treasurers and CFOs have up until now always believed that their commodity was worth twice what it's selling at, so that you could never go and negotiate a transaction. I think you're going to start seeing inflation fears some time in this next cycle and people are going to remember the runaway numbers of the last cycle. You're going to have a lot of companies that are going to finally accept the hypothesis which is the clearest and most sound for the CFO of a company that has a commodity. That is, that if his income is going up, it's because his commodity price went up, and he can afford higher interest. On the other hand, if it turns out his commodity price goes down, he's going to need a lower interest rate.

Taking Principal Positions in Your Own Deals

James P. Gorter
Partner
Goldman, Sachs & Co.

Merchant banking can be defined as the practice of risking your capital. The reasons for this are to:

1) assist your clients in getting a transaction completed;
2) to generate earnings from the particular transaction for yourself.

The trend towards merchant banking, towards investing in your deals, really accelerated in 1986.

Most investment bankers today are really scrambling to ask themselves, is this something that we really ought to be involved in, and if so, how are we going to handle it from a conflict and from a management point of view. We're talking here about really three types of investment, each different, each equally important.

First is providing your client with an immediate credit facility. The second thing is to actually put up the money in terms of a bridge financing. And the third thing is to take a major long-term equity participation in the transaction itself.

If you're basically providing credit lines or bridge financing, you're going to have credit risk. I also think you have a liquidity risk, because you're tying your money up. You probably are taking some kind of a basis risk -- a mismatched risk between assets and liabilities -- and you're certainly taking a long-term market risk if you are providing financing which is not going to be funded out for an extended period of time.

When you get into the equity end of the business, you're beginning to take entirely different risks. You're taking operating risks, product risks, management risks, as well as long-term financial risks. And finally, you may be taking a reputation risk.

Why do we have the trend towards investing in merchant banking type activities? I think what we may be groping for is some new high-margin product that can offset the very high fixed costs we've built up if the world should turn against us, and I think that is probably not a healthy reason to go into it.

People also believe they can leverage their in-house talent by putting the people with expertise in corporate finance, M&A, etc., to work in this capital investment area. That has a certain amount of logic to it but there are some basic problems here. There's a conflict problem. The role of the investment banker traditionally has been the mediator between the users and suppliers of capital. When you begin to act as principal, there is a temptation to put your own interests ahead of your client's.

There's another type of conflict. We actually lost a client because we took a position in another firm's LBO and the first client no longer chose to do business with us because he felt that, in effect, we were a competitor.

But the conflicts to me are really not the thing that gives me the biggest pause. There are dangers of substantial losses and I'm not sure that an investment banking firm which is

leveraged 35 to 1, like we all are, can afford to put itself in a position of sustaining significant losses in any one transaction. If you're going to do just one or two transactions and have just one or two leveraged buyout investments, this may be alright. The problem arises if it becomes a trend, a competitive trend where everybody is trying to outdo everybody else, and people are driven to excesses.

In summary, this is a trend which we're going to have to deal with. It's here. There's going to be competitive pressure on all of us, and yet I am not sure that it is a healthy direction for the investment banking business to go in.

OVERVIEW OF RETAIL MARKET CHANGES

Richard Capalbo
Senior Vice President
Drexel Burnham Lambert Incorporated

The period from 1969 through 1980 was an underperforming time for the stock market. This helped the proliferation of other products because stocks were looked at as unattractive. Then, during the period 1978 to 1985, with extremely high yields available, many clients gave up the stock market entirely and simply went for double digit money market rates at no risk. Also, the individual retail client over this period of time has seen a dominance by the institutional market. This made him feel that things are so complex and that the institutions have such an advantage with all their technology and all their research, that maybe the best way to approach things is to go through packaged products and use professional money managers.

One additional change is that brokers are now starting to get very comfortable with mutual fund products. This is going to have an impact much greater than just on products. It's going to have an impact on broker loyalty and turnover. Many of them have invested in their firm's own funds, or vendor funds, where there's trail commissions and they lose the trail commissions if they leave. Another thing that's important is that the retail business used to be an agency business, and now it's very much a principal business. In order to be in this business you've got to risk firm capital if you want to be creating private label products and want to do sole underwritings.

That's a very expensive luxury, and it's so expensive that you're going to see it start to reverse. New entities will be coming into the financial markets as vendors of product for retail firms.

There's no reason in the world why the same thing shouldn't happen on the marketing side. My guess is that there's going to be a new firm in the next 10 years that does nothing but distribute the best products of many entities who produce products.

International investing -- when you think of the amounts of money that have been raised in mutual funds specializing in foreign investments, it's awesome. A couple of statistics: foreigners purchasing U.S. securities -- bought $3 billion worth of U.S. stocks in 1964. They increased it to $14 billion in 1977 and in 1983, foreigners bought $134 billion worth of securities in the United States. In 1984, U.S. citizens acquired $30 billion of non-U.S. securities.

Now, as far as changes in competition are concerned, I think that merging of financial institutions is still the story of the future. I also think that decreasing firm loyalty will somewhat hamper the financial supermarket approach that started several years ago.

I think you're going to see the consolidation of offices, you're going to start to see economies of scale. You've already begun to see many firms trying to make their offices larger and you've already begun to see account executive's payouts at the low end getting killed. That unproductive broker -- pay him so little that he leaves and goes somewhere else, and let's really pay that big guy real well because he's very profitable, and let's fill our offices with those guys. And also now, if one product is more profitable than another product, let's not pay the broker any more on that one. Let's make the extra margin. Let's make all payouts the same for all products.

Technology is the one story yet to be told. Firms are trying to compete on the basis of delivery of technology and that could be a factor in the future as our children of this computer generation go through training programs and really know how to use it.

MARKET SEGMENTATION AND ASSET GATHERING

Hardwick Simmons
Vice Chairman
Shearson Lehman Brothers Inc.

We see our mission very clearly. We're looking for the affluent. And we define that as roughly 17 million households in the United States who own about 70% of the financial products that we're interested in dealing with. What we've said is we're not going to reach for any other group.

Now, it's really not until we're 40 or so that as a group we begin to accumulate assets, and become of real interest to an asset manager. Before that we've owned a lot of insurance and liabilities, essentially to buy the few assets we needed while we were building our net worth. Our strategy, and perhaps it's a risky one, is to pick those people up at or around age 40, when they begin to accumulate the assets and need the other services that we can provide, as opposed to others in the financial services business who want to grab the individual from cradle to grave.

Once on board, what are your clients looking for? Our clients told us that the most important ingredient is a satisfactory relationship with their financial consultant. They'd rather have a good relationship than see their account be a top performer, because they think within a decent relationship that they will get decent performance. What about price? The price to our clients was 1/20th as important as the relationship they had, which simply goes to show that if we provide value, price is not an issue.

If we're going to go after that affluent group, we have to go after them with a philosophy that tends to their assets. About seven or eight years ago, it seemed pretty apparent to us that our business was an asset driven business, not a transaction driven one. The revenues that we produced were in direct relationship to the assets that we collected, and we could literally forecast what our gross revenues were going to be, based on the assets that we actually controlled. So we stressed asset gathering and changed the name of our account executive to financial consultant, to put in better perspective the relationship we sought to have with all of our clients.

We tell the account executive that the most important thing he can do before opening a new account is to maximize his penetration of the assets of the clients he already has on board. We leave too much on the table as an industry.

Also, the more access you give an individual to his money, the more money he'll give you, so we use a Central Assets Account. If he knows he has to call and fight, you will never see more assets than your individual FC needs to execute the trade on the table at the time. If, on the other hand, he has access through check or credit card to his entire balance with no call necessary, he'll put all those assets in there because he really does buy the convenience argument of a consolidated account.

What about incentives? We compensate our financial consultants with two basis points a year on their assets, and it's deferred and paid to them at the end of five years. You're paying them for what's in your interest as a firm.

Finally, you've got to have your whole organization aware of the value of assets.

First, start with the households. That's where it all comes from. How many households does the average one of your financial consultants have that is active on an annual basis? What are the average assets? What is the asset total that each of them controls? How many new households are being added on a monthly basis? And the only importance of that is, how many new dollars of assets are being contributed? Each of these should be indelibly marked in the minds of your financial consultants, your branch managers, et al, over a period of time, and it becomes a way of life. And finally, you have to relate that to monthly commissions because that's where it all ties in.

So as you can see, if you look at assets as a key to managing your way into the future, and you're willing to go at it with a total approach, it's a major strategy that can insure your health over the next five or ten years.

TRADITIONAL AND PACKAGED PRODUCTS

Donald E. Nickelson
President, PaineWebber Consumer Markets
PaineWebber Incorporated

If you look back, the traditional products were stocks, bonds, and some mutual funds. We're transaction oriented with the traditional products, and we generate commissions and trading revenue.

If you then look at packaged products, the basic difference is that they reach new client segments and provide new benefits to clients. They have reached into the client's savings. The traditional products really couldn't compete for the savings dollar of the customer but packaged products have allowed us to do that. The other thing that's happened is that clients look for professional management of their funds.

If you look at total revenue in the securities industry, in 1980 about 12 1/2% was made up of packaged product revenue. By 1986, it was almost 37%. So you can see that packaged products are growing very rapidly.

The compound annual growth rate for the industry of commission income has been about 6 1/2% since 1980. If you add commission and trading together, it's been 14%. If you looked at fee income, it's 32 1/2%, but fee income started at a very low base. The one that has really driven packaged products has

been mutual fund commissions -- 58% compounded annually since 1980. So it's going to be a very, very powerful part of our business as we go forward.

The Tax Reform Act is going to change some of the direction of packaged products and traditional products as you look forward. Investors' decision-making is going to change, because it's not going to be based as much on tax considerations as it is on investment considerations.

People are also going to be looking for double digit returns that they got hooked on in the late 70s and early 80s. We think that probably lends itself to packaged products. You're going to have master limited partnerships. You're going to have high-yield securities and we're going to package that and manage it more intensely. You're going to see more convertibles, you've got the alternative minimum tax so for municipal bonds we're going to create vehicles to package those for a segment of the market. We think generally it's going to be a big part of the market for a lot of firms, and is going to drive the package concept even further.

The other big thing that we see out of this tax act is life insurance as an investment. You're going to see all of the major firms or most of them in some kind of a life product where we can have our mutual funds wrapped in either a variable annuity or a single premium life product because that is the one place you can still have tax advantages.

The 35 to 45 year-olds in the 1990s are going to be a growth segment. They are basically looking for lending and insurance products.

The accumulator, that's a large part of all of our client bases, is going to grow very rapidly in that decade also, so that's going to be a real growth market and there will be both traditional and package products there.

The retirement market, or the people just getting ready to retire, 55 to 64, have a lot of assets and are going to be looking for different products. The last category is the post-retirement or the retired people. By the year 2000, this is going to be the largest group of very wealthy, affluent and well-educated people in the history of this country, so there's going to be a ton of money out there.

And what might some of the implications be of all this? For that younger group, it's going to be lending or insurance. Traditionally, the brokerage industry has not had products for that group but by 1990 we are going to begin to create products for that group. We don't have them today, but I think that's a segment that we'll be looking at and creating products for, and maybe it's more insurance.

The accumulator is probably going to be looking for some trading and some investing in products and we see the packaged products developing more than traditional ones.

The retirement planning group will want more products that are services and planning. We don't really have them today, but in our marketing we are trying to understand what they are, package them, put them together, because we think that it's a segment that we'll go after.

That last segment, the post retirement, that has all the money and is well-educated, is really looking for service. Maybe we can put together a package of securities and you're going to pay their bills when they travel. They're looking for convenience. Again, we don't have that package, but at least I can describe it and think about it. I think those are the kinds of packaged products that you'll see go forward.

Again, I believe that packaged products will continue to grow faster than traditional products and that this is not just a short-term phenomenon.

I think that these are the underlying reasons for that. First is tax change. Taxes will drive packaged products. The demographics of the 80s, late 80s and 90s, again I think will drive more packaged products. I also think the whole concept of managed money is one that won't go away. I think that convenience is going to be more and more important and you just can't get convenience out of traditional products. So I think packaged products are the winner.

REFLECTIONS ON WALL STREET

Donald E. Weeden
Chief Executive Officer
Weeden & Co.

At May Day, there was doom and gloom everywhere on Wall Street. Today is entirely different. I didn't see one down curve on any of those beautiful slides used today and I agree with them. I think the future looks good for our industry. I think it looks extraordinary. If you go back over the last 10 years and look at the numbers, you see that there was a quantum leap in almost every statistic, whether you're talking about volume on the New York Stock Exchange, capital in the hands of the brokerage firms, revenues or profitability. There was a ten-fold increase in all of those. I believe that we will have another ten-fold increase in all of those things across the board.

The competition that started in 1975 was combined with an extraordinary creativity that started back as soon as May Day was finished and everybody said, "we've got to get down and figure out how we're going to develop products that we can sell to people and be profitable if we lose all these commissions", and they went ahead and did it. The creativity and the expansion of products in the last 10 years is overwhelming, and I think that will continue in a heightened degree as we better use the technology that's available to us. I think that we're going to find that equities and bonds are a narrow area, as we already have, and that what we have done to make complex our particular industry over the last 10 years, is going to be magnified enormously by the opportunities that are going to be out there of switching from one currency to another, from bonds in one country to stock in another, and so forth. If you take a look at it, it goes beyond geometrical progression.

That trend doesn't mean that the regional firms are going to be left out of it. All of this growth and complexity and demand on companies isn't going to ever take away that one extraordinary thing that they have, and that is the closeness to their customers.

I don't mean to say that there aren't any problems in the future. I've been a dealer all my life, I felt that taking risk and providing that service always deserved a higher rate of return than being a broker. The mix of customers are forcing the street to become more and more of a dealer and it is a more profitable business line. Those are good reasons to do it.

Some of the negative reasons are the enormous competitive pressure that there is to become a dealer. I think that indicates signs of getting into some future trouble. I think that this drive for market share is another disturbing thing, because I think people are going to be doing, over the next 10 years, a lot of the things that as a businessman they really wouldn't want to do, but they justify it in terms of market share. There is going to be a leveraging in dealing that may go beyond what is responsible.

I think that when investment banking firms begin to get into LBOs and commit a great deal of their capital and have this enormous opportunity to borrow from the banks, there will be enormous profit in that business for a while. There will be enormous competitive pressure, market share tendencies and so forth, and we're going to find that there is leverage in this marketplace that is not a great deal different than the leverage that was in the marketplace in the 20s.

This market is going to continue for a while and it will gather like a fire storm. We'll jump on the bandwagon and then

it will stop. It's going to stop like a car when you put on the brakes and we've got an awful lot of leverage out there -- we could have a real problem.

But all of the other major trends -- which include dealerization, globalization, technical advances, creativity, complexity of the markets, deregulation, the coming together of accounting procedures throughout the world -- are benefiting us all. The one really positive thing is that the amounts of monies that will be available to buy the products that we are primarily involved in, and are very good at developing and marketing, and know a lot about, is going to continue to increase both at the retail and the institutional level. And it can be that kind of swelling up that will save us all from a lot of mistakes that we might make along the way.

I would caution everybody to keep reminding yourselves that we're here to service somebody. If we can do a good job of that, then we can make a reasonable return on our time and effort. If we get greedy and forget about that servicing, and get caught up with the game of monopoly that we're all playing, and we become more and more detached from the realities that underlie our economy, then I think that we have troubles. If we can avoid that in our own thinking, both managers and people who are out there on the firing line, then I think we've got an enormously exciting, profitable decade ahead of us.

VOLUME

	DEC 1986	JAN - DEC 1986	DEC 1985	JAN - DEC 1985	% CHAN. J-D 1986-1985
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	148.2	141.0	133.4	109.2	29.1%
AMEX (MILS.)*	12.3	11.8	13.0	8.7	42.2%
NASDAQ (MILS.)*	119.2	113.6	106.0	82.1	38.4%
REGIONAL EXCHANGE (MILS.)*	N/A	N/A	23.1	18.8	N/A
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$122,915	$1,374,350	$102,773	$970,479	41.6%
AMEX (MILS.)	3,218	43,649	2,303	26,710	63.4%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	11,527	108,517	7,728	78,820	37.7%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	27,150	220,640	19,431	184,470	19.6%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.8%	49.9%	49.6%	51.7%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	N/A	N/A	16,326	148,888	N/A
AMEX OPTIONS	4,468	65,443	5,573	38,288	70.9%
COMMODITY	N/A	N/A	13,459	158,695	N/A

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

	DECEMBER 1986	DECEMBER 1985	BASIS POINT CHG 1986-1985
BOND BUYER INDEX (20 BOND)	6.86%	8.43%	(157)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	8.49	10.16	(167)
Baa CORPORATE	9.97	11.58	(161)
RATIO Aaa CORPS. TO Baa CORPS.	0.85	0.88	N/A
MUNICIPAL BOND YIELDS (MOODY'S)	6.86	8.43	(157)

PRICES

(END OF MONTH)

	DECEMBER 1986	DECEMBER 1985	% CHAN. Y-T-D 1986-1985
DOW JONES INDUSTRIALS	1896.95	1546.67	22.58%
STANDARD & POOR'S 500	242.17	211.28	14.62%
NYSE COMPOSITE	138.56	121.56	13.98%
AMEX MARKET VALUE INDEX	263.27	246.13	6.96%
VALUE LINE COMPOSITE	225.62	214.86	5.01%
NASDAQ COMPOSITE	348.83	324.93	7.36%

UNDERWRITING

	FULL YEAR 1986	FULL YEAR 1985	% Change 1986-1985
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$285,331.8	$138,287.9	106.3%
Common Stock	$43,047.0	$24,727.4	74.1%
# of Common Stock Issues	1,197	745	60.7%
Preferred Stock	$13,982.8	$8,632.5	62.0%
# of Preferred Stock Issues	187	131	42.7%
Corporate Debt	$228,302.0	$104,928.0	117.6%
# of Corporate Debt Issues	2,383	1,346	77.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$110,815.2	$172,138.0	-35.6%
# of Issues	3,072	4,264	-28.0%
Competitive	$32,756.0	$27,142.2	-20.7%
# of Issues	3,430	1,002	-242.3%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Securities Industry Data Guide	Directory of sources of securities industry data in seven major areas: Employee earnings; firm listings; firm rankings; general market information; mutual funds; securities industry profitability, and underwritings. Listings show description of data, cost name, address and phone of the data source.	SIA Publications Department $5 each
Annual Report - Federal Reserve Bank of New York	In a departure from its traditional style, this year's report presents President Corrigan's essay outlining a future structure for the financial markets. Although a very broad-brush approach is applied, the financial structure envisioned is radically different than the current one. Inherent in the new model is the elimination of many legislative barriers between financial intermediaries, including the Glass-Steagall Act, and an extension of Fed supervisory power.	Federal Reserve Bank of New York 33 Liberty Street New York, NY 10045
"Regionals Blast Majors With Growth"	Annual rankings, 1986 vs. 1985, of Regional securities firms for their corporate underwriting activities. Top 15 lead managers are shown for categories: all issues; debt; common stock, and IPOs. Also, rankings are broken down by geographic regions such as Northeast and South Central.	Investment Dealers Digest 1/26/87

Economic Report of the President	Annual report reviewing economic developments that shaped 1986. Main topics of the seven-chapter report include budget control and tax reform, competitiveness and the trade deficit, and opening of international markets. Extensive historical statistics section, with most data series extending back to inception.	U.S. Government Printing Office Washington, D.C. 20402
"Riding the Wild Bull"	Barron's/Lipper gauge of fourth-quarter 1986 performance of mutual funds, along with articles on option funds, closed-end funds and how to figure taxes on fund shares.	Barron's 2/16/87
Financial Innovations Made to Measure	Series of articles, written with an international slant, reviewing new financial products and their success, or lack of it, with investors. Of the numerous financial innovations in 1986, it is estimated that 85% were driven by special interest from Japan, particularly insurance companies.	Euromoney Supplement January 1987
"Top 1,000 Pension Funds"	Employee benefit assets of the nation's 1,000 largest pension funds grew almost 25% to $1.3 trillion during the year ended 9/30/86. The growth rate was on par with the previous year and attributed largely to investment returns. Article ranks 1,000 funds by asset size and presents profiles, including key personnel, for the 200 largest.	Pensions & Investment Age 1/26/87

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